

VZCZCXR05258

RR RUEHDA RUEHDE RUEHDH RUEHIHL RUEHKUK

DE RUEHBC #0054/01 2701225

ZNR UUUUU ZZH

R 271225Z SEP 09

FM REO BASRAH

TO RUEHC/SECSTATE WASHDC 0924

INFO RUEHGB/AMEMBASSY BAGHDAD 0502

RHMFISS/DEPT OF ENERGY WASHINGTON DC

RUCNRAO/IRAQ COLLECTIVE

RUEHBC/REO BASRAH 0962

UNCLAS SECTION 01 OF 03 BASRAH 000054

SIPDIS, SENSITIVE

E.O. 12958: N/A

TAGS: [ECON](#) [EINV](#) [ENRG](#) [EPET](#) [PGOV](#) [IZ](#)

SUBJECT: BASRA: A GLUM SHELL WONDERS ABOUT NEXT STEPS ON (DELAYED?)
FLARED GAS DEAL

REF: A. BAGHDAD 1960

[¶](#)B. BASRAH 36

[¶](#)C. BAGHDAD 1151

[¶](#)D. BAGHDAD 955

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[¶](#)1. (SBU) Summary. During a recent visit to Basra, Royal Dutch Shell representatives told PRT EconOff that local stakeholders expressed continued strong support for its flared-gas project. However, they also expressed frustration about Shell's apparent inability to finalize the deal with the GOI anytime soon, evidently due to GOI's political hesitation ahead of upcoming national elections. Media reports have also hinted at a possible delay, also citing the January 2010 elections. Local Basra businesses and government leaders have also widely noted a "wait and see" attitude among businessmen, who now prefer to wait until the formation of the next GOI before committing to any new projects. For Shell, any such a delay past elections could translate into several more months of uncertainty. Nonetheless, despite their frustrations, Shell reps told EconOff that given the project's vast potential, they are "in it for the long haul," and reminded us that they work in "tougher climates" in many parts of the world. And if indeed the project is delayed (and this is still uncertain), maybe it is best in the long run for Shell to deal with a new GOI in power in 2010, rather than negotiating with what is now essentially a lame duck GOI. And for a project that could be a multi-decade, multi-billion dollar deal to the benefit of many Iraqis, it could be worth the wait. End summary.

Project offers financial, environmental benefits

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[¶](#)2. (SBU) As reported in refs C and D, the South Gas Utilization Project is a 51-44-5 percent, South Gas Company (SGC)-Shell-Mitsubishi joint venture (JV) to gather, process and market the natural gas currently flared (openly burned) from Basra Province-based oil fields. (Note: As forecast in ref B, Mitsubishi recently bought a five percent stake in the JV. End note.) The project commits Shell to install processing facilities and other infrastructure required to end the flaring of about 700 million cubic feet per day of associated gas. A preliminary "Heads of Agreement" deal signed in September 2008 called for a final agreement within 12 months. Among the pending agreements are a Shareholder Agreement, South Gas Development Agreement, and a pricing mechanism. A final approval by the Council of Ministers (COM) is also required.

[¶](#)3. (SBU) The benefits to Basra and the Iraqi treasury are clear. According to Shell, the flared gas is equivalent to 130,000 barrels/day of oil, and the energy equivalent of 3,500 megawatts of electricity, the latter almost half of Iraq's current production. According to Shell, the lost commercial value from this flared gas is USD 6 million per day, or about USD 70 per second. The dry gas and natural gas liquids, including

liquefied petroleum gas (LPG) produced by the JV could allow Iraq to reduce its weekly current LPG imports of 4,000 tons. The GOI would also benefit from Shell's 15% corporate tax payments and SGC's 51% share of any JV net revenues. Last but not least, and according to Shell's calculations, the elimination of this gas would save 20 million tons per year in CO₂ equivalent emissions, which equates to the emissions from three million cars.

Shell's latest Basra visit, and continuing "quick wins"

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¶4. (SBU) Shell's latest visit to Basra, led by security and infrastructure executives Ms. Elsine Van Os and John Davies, included meetings with its local staff, subcontractors, members of the Provincial Council, the Basra Investment Commission, and the U.S. 34th Infantry Division Commander. According to Shell, local stakeholders expressed their continued support for the project. Shell representatives also reviewed for Basra PRT EconOff its several months-long "quick win" projects, which they admitted are designed in part to win public approval for the project. Projects include the rehabilitation of an 18 MW generator at the Rumaila oilfield, which will help SGC achieve electricity self-sufficiency (allowing more electricity to a power-starved public); the rehabilitation of a dry gas compressor to facilitate gas export; and the refurbishment of two vocational technical schools (which will also supply graduates for Shell to hire).

South Gas DG also expresses general optimism

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¶5. (SBU) Separately, in two recent meetings with PRT EconOff, South Gas Director General Mr. Ali Hussein Khadayer expressed enthusiasm about the Shell project, that it will help raise gas production, and that it had the support of workers and management ("there is no controversy" about it). (Note: While

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Ali said that the project is still on track for a late 2009 final agreement, SGC plays no role in negotiations, as all decisions are made within the MOO. End note.)

Still, project could face delays

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¶6. (SBU) However, Shell acknowledged that signed contracts and final COM approval that had been previously expected by the July to September timeframe remain elusive, for several reasons. They indicated that the main problem, and the one widely heard in Basra business circles, is the upcoming January elections, which they contend are complicating GOI efforts to finalize the Shell deal. They also indicated that disagreements have emerged between Shell and MOO on the asset valuation study that accounting firm Ernst and Young did (ref C), and which will establish the current replacement value for SGC's facilities. According to Shell, the study will establish a value on the GOI contribution to the JV, and the less value that a dilapidated SGC infrastructure is considered to be worth, the more MOO would theoretically have to pay. Shell also cited bureaucratic problems delaying the deal, with the recently-concluded 27-day Ramadan season which slowed down negotiations, and more generally, the MOO bureaucracy which they contend lacks the capacity to negotiate and execute these Shell contracts.

Shell's frustration

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¶7. (SBU) Davies and Van Os expressed frustration, impatience and even some surprise at the GOI's "irrational" and "self-defeating" behavior for such a "clearly beneficial" deal. Despite one year of time-consuming and expensive work executing quick wins and lobbying the GOI and interest groups, the GOI "can't see how important this project is and that it is in everyone's interest." Although Shell has not made figures available, so far, project's costs so far could be in the range

of tens of millions of dollars. They acknowledged that a delay until after elections could translate into months more of delay, as it could take an additional several weeks or months for a new government to form. They said that despite all their lobbying and outreach, there is still a lot of "resistance" to and "ignorance" about Shell's intentions, and that there is still a very strong belief in Basra (and Iraq) that foreign companies will do nothing but "exploit," "hurt workers," and in this case raise gas prices.

Media reports also hint at delay

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¶ 18. (SBU) Recent media reports have also indicated a possible delay. Deputy Oil Minister Ahmed al-Shamaa was quoted last week that the political atmosphere was "not right" for the Shell deal because of the focus on the election, and that the deal is likely to be delayed until after the election. Oil Ministry spokesman Assem Jihad said that while an agreement was "not far off," he acknowledged that negotiations "are still ongoing, and the one-year deadline can be extended." Other media reports have cited objections from "nationalist" legislators and worker groups, who argue that the deal would allow Shell to monopolize the area's gas market, and unduly influence prices.

Local businesses also in a "wait and see" mode

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¶ 19. (SBU) Local contacts also note a widespread local perception that due to elections and attendant uncertainties about the composition of the next national government (and its views about foreign investment), many businesspeople are now in a "wait and see" mode. They contend that it is unknown "who will be on top and who will be out of a job," and that it would be pointless to negotiate contracts with people who may be out of a job soon, and for projects that could soon be out of favor. Prospective investors -- Iraqi and foreign -- think it best to let the dust settle after post-election horse-trading, which could take weeks or months after the January election. Even Basra-based UK diplomats, keen to see the deal move forward, acknowledge that signing the deal at this late stage of the GOI's term could be difficult.

But Shell still in for the long haul

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¶ 110. (SBU) Shell reps said that while "there is a limit to our patience," and despite the delays and "pressures from Shell headquarters," for now it has no plans to give up on the project, as potential returns are still too great to walk away from. They also pointed out that Shell's activities seek to create whole new areas of wealth with this new source of gas and revenue, so it is not threatening any existing or vested

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interests. They said that this fact could stand in contrast to many international oil companies (IOCs) seeking business in Iraq which could sometimes open up a "hornet's nest" with the prospect of new and transparent business practices that might threaten local interests (such as IOCs' intentions to meter production and/or exports, any lack of which is alleged to facilitate theft). While Shell certainly plans to observe strictly transparent business practices, by creating entirely new sources of wealth, it could face less local resistance to its activities.

And is experienced in tough climates

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¶ 111. (SBU) Van Os and Davies reminded PRTOffs that while for some IOCs, working in Iraq might seem risky, Shell actually faces equally tough or tougher environments in places such as Nigeria, Russia, and Venezuela. Nevertheless, they admitted that Iraq presents "its own set" of unique and complex security, bureaucratic and political challenges, many of which they've not encountered before. On this latest trip, Shell sought the PRT's

own security assessment of Basra. They noted that Shell's corporate headquarters is "extremely risk averse" to the potential loss of life -- and Mitsubishi is "even more so." Senior Shell representatives (and PRTOffs) were present during a March 2009 rocket attack on the Basra COB, and the event evidently sent them back to their Kuwait base to re-assess. Nevertheless, they came back.

Comment

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¶12. (SBU) While a possible delay is frustrating to Shell, such holdups during election seasons are not uncommon in democracies in the run-up to a big election, as people in power (who seek re-election) can be reluctant to make decisions that can be used against them for political gain. GOI politicians are very sensitive to the perception of any "giveaway" to Shell, or otherwise having their nationalist credentials questioned. And the fact that Shell's was a "no-bid" contract could make some politicians even more wary (even though there are strong legal arguments against the need to tender this "mid-stream" activity - ref C).

¶13. (SBU) And as hard as a delay might be for Shell, if there is a delay, maybe it is best in the long run. A deal signed with the next government, rather with a government in its final days of power, could have more staying power. Signing a deal now could be a waste of time and money if a radically different GOI comes into power. And if the Shell flared-gas deal truly is one than can be a multi-decade, multi-billion dollar project benefiting a wide sector of the population, which we believe it can be, it could be worth the extra months wait.

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